Washington State Auditor's Office

Audit Report

Audit Services

Report No. 5796

DEPARTMENT OF TRANSPORTATION

Agency No. 405

July 1, 1995 Through June 30, 1996

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TABLE OF CONTENTS

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Overview

We performed the statewide single audit of the state of Washington for the fiscal year ended June 30, 1996. In accordance with the Single Audit Act of 1984, we audited the state as an entity, rather than each agency separately. The results of this audit will be published in a statewide single audit report which includes the following:

- An opinion on the financial statements.
- A report on internal control structure-related matters based solely on an assessment of control risk made as part of the audit of the financial statements.
- A report on compliance with laws and regulations that may have a material effect on the financial statements.
- An opinion on supplementary Schedule of Federal Financial Assistance.
- A report on internal controls over federal financial assistance.
- An opinion on compliance with specific requirements applicable to major federal financial assistance programs.
- A report on compliance with general requirements applicable to federal financial assistance programs.
- A report on compliance with laws and regulations applicable to nonmajor federal financial assistance program transactions tested.
- A Schedule of Findings and Schedule of Questioned Costs.

The work performed at the Department of Transportation included procedures to satisfy the requirements of the 1996 statewide single audit and supplemental reviews and tests deemed necessary in the circumstances.

There were findings, which are listed in the Schedule of Findings following this Overview, for the Department of Transportation.

Brian Sonntag, CGFM
State Auditor

February 20, 1997

Schedule Of Findings

1. The Department Of Transportation (DOT) Should Monitor Subrecipients In Accordance With Federal Guidelines

DOT distributed approximately $100 million in federal funds to local governments during fiscal year 1996. Federal regulations require DOT to monitor the use of these funds. We reviewed all 19 of the subrecipient audit reports with federal findings. In 14 of these reports, we found that corrective action had not been taken within the six month period required by federal regulations.

The Office of Management and Budget Circular A-128, Section 9, Subrecipients states:

> State or local governments that receive Federal financial assistance and provide $25,000 or more of it in a fiscal year to a subrecipient shall:
>
> a. determine whether State or local subrecipients have met the audit requirements of this Circular (A-128).
>
> b. determine whether the subrecipient spent Federal assistance funds provided in accordance with applicable laws and regulations . . . by reviewing an audit of the subrecipient made in accordance with this Circular (A-128).
>
> c. ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of noncompliance with Federal laws and regulations . . . .

Two causes were noted for the lack of timely corrective action taken for the cited subrecipient findings: DOT policies and procedures do not provide sufficient guidance for assuring timely corrective action is taken for subrecipient findings that do not contain questioned costs; and the DOT interpretation of A-128 subrecipient monitoring requirements did not require timely corrective action be taken for certain subrecipient findings.

Failure to review subrecipient audit reports and ensure that appropriate corrective action is taken timely results in a lack of assurance that subrecipients are properly administering federal funds received from DOT.

We recommend that DOT improve its monitoring of subrecipient entities.

Auditee's Response

Partial Concurrence

We agree that five subrecipient findings were not resolved in the prescribed time period, but all subrecipient audit reports were reviewed, and questioned costs have been, or will shortly be, recovered. TransAid's subrecipient monitoring procedures were developed with the assistance of the State Auditor's Office (SAO) and we will continue to work with SAO to improve these policies and procedures.

TransAid does not concur that they should be held accountable for resolution of subrecipient findings that do not directly involve Federal Highway Administration (FHWA) grant funds. Six subrecipient findings dealt with fixed assets which do not ordinarily qualify for FHWA grant funds. No costs were questioned, and the SAO auditor stated (in the Single Audit report on internal control structure used in administering federal financial assistance programs) that the findings were not material.

Subrecipient findings that indirectly affect the FHWA grant program can be costly and time consuming to remedy. Seven findings stated the subrecipients should integrate separate grant tracking systems into a centralized accounting system. We believe that in many cases this would be a financial hardship, or simply not economically feasible to pursue corrective action. In addition, even if changes are undertaken, the length of time necessary to integrate a separate grant tracking system into a centralized system can be extensive. It is unrealistic to believe the state can control the timeline for completing this type of activity. To reinforce our position, we offer the following examples of problems encountered by those subrecipient agencies cited by the SAO:

Lincoln County bought a canned software package for a cost of approximately $30,000 which has now climbed to $37,000. This cost is for the software only and does not include staff time. They started the project 18 months ago and are still not complete.

Adams County plans on purchasing a software package at an estimated cost of at least $50,000. The vendor indicated it would take approximately 9 months to bring the system on line. This is 3 months longer than OMB (Office of Management and Budget) and SAO expectations for corrective action.

City of Pullman has paid out $2,500 for programming, and an additional $1,000 for staff training and have spent 2 years using their own staff to change their system. They could not put a dollar figure on their staff time, but they have indicated there were 4 people from 3 departments responsible for completing the project, and others were brought in to help as needed. They are still adding refinements, and have had SAO involved every step of the way.

TransAid looks forward to working with the SAO to reassess our procedures to ensure continuing excellent service to our customers.

Auditor's Concluding Remarks

We address the areas of agency partial concurrence as follows:

Our interpretation of the A-128 requirement regarding subrecipient monitoring was coordinated within SAO; the interpretation outlined in the finding is the result. We are currently in contact with the USDOT/OIG regarding this matter. However, until there is definitive guidance to the contrary, we affirm our interpretation of the circular.

As noted in the WSDOT response, some of the subrecipient corrective actions are long term and will not be completed in a six month period. In these instances, the expectation is that DOT will actively monitor progress to the conclusion. We will review the process in the fiscal year 1997 audit.

The requirements of subrecipient monitoring pertain to any finding related to federal compliance or internal control regardless of materiality.

Additionally, it should be noted that federal guidelines for subrecipient monitoring are in transition at this time. SAO will keep WSDOT apprised of new information as it is received.

2. The Department Of Transportation (DOT), Washington State Ferries (WSF) Should Strengthen Controls Over Ticket Sales And Revenue Collection At The Ferry Terminals

During fiscal years 1995 and 1996, WSF implemented the Point of Sale (POS) system and continued the implementation of the Automated Revenue Control System (ARCS) for sales and revenue collection at ferry terminals. Our audit of sales and revenue collection at the ferry terminals revealed the following weaknesses:

a. Revenue collection controls at the point of sale do not provide reasonable assurance that recorded transactions are complete and accurate.

b. WSF has documented policies and procedures for revenue control and collection, which presented a significant improvement from prior years. However, our audit indicates the policies and procedures are incomplete because many segments of the WSF operations related to fare revenue collection and controls have not been addressed. In addition, our audit indicates that the policies and procedures are not consistently complied with by staff.

(1) Our testing indicates that sellers do not consistently void or refund transactions immediately after the initial transaction occurs and the required supporting documentation for voided or refunded transactions is not maintained.

(2) Sellers do not always invalidate commuter coupons upon receipt from patrons.

(3) Terminal agents do not always prepare variance activity reports in accordance with policies and procedures.

c. WSF has not fully implemented all the variance monitoring processes in the manual. Our testing noted that WSF does not consistently review and analyze voids, refunds, and overs/shorts of sellers for validity. In addition, WSF does not reconcile the actual number of commuter coupons received by the sellers to the number of coupons recorded in the system.

d. Transactions are frequently recorded in POS system while the cash drawer remains open.

e. Access to cash receipts is not properly restricted when WSF employs on-call agents. An on-call terminal agent is a part-time agent who may work at multiple terminals as a terminal agent or as a seller. These employees have access to combination numbers for the drop safes and terminal agent's safes at all terminals where they act as on-call agents. As a seller at the same terminal, these employees are required to deposit sales revenue into the drop safes, yet they also have knowledge of the combination to the safe.

f. WSF does not retain cash receipt records, off-line sales reports, armored transport receipts, remittance adjustment forms, and cash pick up reports in accordance with the revised records retention schedule filed with the Office of Secretary of State.

Also, the retention responsibilities in the WSF manual do not agree with the agency approved retention schedule resulting in destruction of WSF records in violation of the agency approved schedules.

g. Controls over the transfer of sales proceeds from sellers to terminal agents should be improved. Presently, the proceeds are placed in a drop safe by the seller and later retrieved by the terminal agent. This method does not provide independent verification or acknowledgment of the receipt of the funds. WSF reported two losses totaling $644.00 during fiscal year 1996 and two losses totaling $642.00 in fiscal year 1995 related to the transfer of sales proceeds.

h. Four of five WSF terminals tested did not deposit cash receipts within 24 hours of receipt.

i. WSF uses an off-line sales and revenue collection system when the POS system is inoperable. The off-line sales process does not have adequate controls to ensure completeness of revenues, i.e., sellers do not issue receipts to all the customers and mode of payment is not noted. During the period of December 1995 through August 1996, $68,622.43 of sales were collected through the off-line process.

We previously reported finding conditions a. through g. in the 1995 *State of Washington Single Audit Report* (SWSA) Finding 41 and in the 1994 SWSA, Finding 48. Condition a. was first reported in the 1986 SWSA.

Also, the DOT Internal Audit Office has previously reported similar weaknesses related to WSF ticket sales and revenue collection.

The State of Washington Office of Financial Management (OFM) *Financial and Administrative Policies, Regulations, and Procedures* manual, Section 6.2.2.1.1. provides guidance on minimum internal control procedures necessary to control cash receipts.

OFM Section 6.1.1.2.4.(b).(2) states in part:

> Every effort is to be made to ensure that the assets of the state are properly handled. By supplying employees with strict control procedures and ensuring that they are followed through the use of checks and audits, the chance of losses will be greatly decreased.

Revised Code of Washington (RCW) 40.14.060 states in part:

> Any destruction of official public records shall be pursuant to a schedule approved under RCW 40.14.050 . . . Recommendations for the destruction or disposition of office files and memoranda shall be submitted to the records committee upon approved forms prepared by the records officer of the agency concerned and the archivist.

WSF management asserts that these conditions continue to exist because the new Point of Sale system was installed for only part of the fiscal year in some locations, the lateness in the fiscal year that the new policies and procedures were implemented and the need for additional procedures to strengthen controls.

Lack of an adequate system of internal control creates a situation in which misappropriation of public funds could occur without detection.

We recommend that the Washington State Ferries continue to develop and implement controls to provide reasonable assurance that public funds are safeguarded.

Auditee's Response

a. Concurrence

The installation of a new Point Of Sale (POS) system has provided enhanced revenue collection controls at the point of ticket sale. The POS system includes electronic displays visible to the customer allowing them to verify the value of the recorded transaction. POS provides management data to identify unusual selling activities. WSF has issued comprehensive written policies and procedures which require daily review of sales data by terminal agents. We continue to rely on the issuance of a cash register generated receipt to the customer when payment is received as an important control. There are signs at all terminal locations telling our customers that a receipt must be issued by the seller and provides a phone number for the DOT Internal Audit Office at WSF if a receipt is not issued. Also, we do receive calls and letters from customers when they believe there is reason for concern. We investigate all circumstances brought to our attention by staff or customers. Any indications of potential fraud have been, and will continue to, be reported.

There is no way to provide absolute assurance that recorded transactions are complete and accurate. This is true in any high volume retail environment. We will continue our efforts to develop analytical reports for review by appropriate staff. Enhancements to the POS database are necessary to complete this task. Design for the enhancements is underway, but we do not have a certain completion date at this time. Project staff have an estimated completion date of August 31, 1997. We will also develop a customer awareness campaign utilizing a brochure that can be easily distributed at terminals and on the vessels. We will have this in place by October 31, 1997.

b. Concurrence

The written policies and procedures for revenue collection and control will continue to be strengthened and enhanced. One revision was issued in February, 1997, and eight more will go out during March and April 1997. We will continue to stress compliance with our employees. At the time field testing was done, the policies and procedures were relatively new. Time and experience should improve compliance.

1. WSF procedures for revenue collection and control for voids and refunds do not explicitly state that sellers are required to process them "immediately after the initial transaction occurs." For refund transactions, this would be impossible because the seller cannot determine what the customer is going to do in the future. However, we need to clarify the language in the procedures manual for voided transactions. The goal is to record voided transactions as quickly as possible into the POS device without having a negative impact on traffic flow (especially near vessel departure time). Operations planning estimates they will issue a clarification to the procedure manual by June 30, 1997.

The WSF revenue collection and control procedures manual, section 2.2.5. on page 2-18 and 2-19 provides guidance to the sellers for batching and remitting void and refund documentation to the terminal agents at the end of their shift. Section 2.3.1 of this manual provides guidance to the terminal agents for reviewing void and refund documentation. Section 9 of this manual provides guidance to the terminal agents on what to do if the seller does not maintain compliance with the procedures for voids and refunds. Operations planning will review these areas and determine if a procedure clarification is necessary by June 30, 1997.

2. WSF procedures for revenue collection and control for prepaid fare, section 3.1.4, item 4 states "Seller immediately records the transaction into POS and cancels the document if it is a prepaid ticket. WSF recognizes that customer volumes do not always allow immediate processing of prepaid media. During high volume times prepaid media must be processed as soon as possible." We will continue to stress the importance of timely cancellation of documents.

3. WSF Operations planning is actively working on improving compliance. We tested January 1997 for all terminals and are requiring agents to follow through on unreported variances. We will continue to test this (three-four times per year) to encourage compliance.

c. <u>Concurrence</u>

Training in this area has been completed. The POS enhancements mentioned in item a. above, should provide the final piece of information necessary for full implementation. This will include random reconciliation of commuter coupons received to the number recorded in the system.

d. <u>Non-Concurrence</u>

A test has been conducted which shows a significant increase in time to process transactions when requiring the cash drawer to be closed after each transaction. Therefore, as noted in last year's response, the practice of leaving the cash drawer open is necessary to support the rapid processing of transactions to move passengers and traffic onto the ferries during peak times, to minimize congestion and to meet our schedules. We believe the resulting risk is acceptable in light of our transportation mission.

e. <u>Partial Concurrence</u>

Access to safes by on-call and part-time agents is addressed in the written policies and procedures. (8.3 Separation of Functions). To restrict the on-call agent from performing agent duties at the terminal where they work as a seller (other than the current policy restriction on working when they have a remittance to be verified by the agent) would be a significant cost to the agency. This is especially true of Anacortes. We have not been successful having on call-agents work that terminal both for relief and as a temporary (extended relief). We would often fill on overtime, but the travel and mileage costs exceed the risk of loss. Since no specific losses have been identified because of this condition, we will look for low cost opportunities to reduce the risk.

f. <u>Concurrence</u>

WSF will revise the policies and procedures to reflect appropriate retention requirements. This will be done by June 30, 1997.

g. <u>Non-Concurrence</u>

The new POS system improves this situation by providing the terminal agent with adequate data to identify suspected losses within the past business day and allows the initiation of an investigation, should such an apparent loss occur. Any potential improvements identified to date, such as verification of funds with both parties present, are cost prohibitive.

h. <u>Concurrence</u>

We know of two locations where we need to modify the arrival time of the armored car for delivery of the deposit to the bank. (The alternative is modifying the agent schedule, but then they are unavailable for peak traffic and terminal operations management later in the day.) We will work with the armored *car company to see if schedules can be adjusted. From time to time any agent might be unable to complete the report by the time the armored car arrives. This mainly would occur because of an operating demand requiring attention. We will consult OFM regarding these operational variances and look for an acceptable solution by June 30, 1997.*

i. Non-Concurrence

The off-line sales of $68,622.43 were only 0.1% of the approximately $55 million in sales during the period tested. When operating in an off-line environment, we are usually without power or network connection. We are trying to process passengers in a manual environment and maintain our schedule. Handwritten individual receipts or another fare media that has to be printed, secured, inventoried or controlled are not cost effective or operationally viable solutions.

Auditor's Concluding Remarks

We address the conditions for which the agency indicates partial and nonconcurrence as follows:

d. The WSF *Policy and Procedures* manual states: "After completing a transaction, sellers will make every reasonable effort to close the POS cash drawer. WSF recognizes that heavy traffic flow does not always allow for this." We tested POS procedures at eight WSF terminals and observed that cash drawers were frequently left open at times other than periods of "heavy traffic flow." Accordingly, we affirm this condition. We will review the process during the fiscal year 1997 audit.

e. We view the exposure for WSF in this area as significant and therefore strongly encourage continued search for a solution.

g. We acknowledge that the POS provides a tool for review in this area. However, the continued loss experience noted in this condition combined with the risk identified in condition "e" and the failure of agents to report as required by WSF *Policies and Procedures* in condition "b" indicate risk continues to exist in this area. Accordingly we reaffirm this condition.

i. The figure noted in this condition reflects only the public funds reported as being collected during off-line operations. There is no assurance that this amount is in fact the total collected during off-line operations. Our intent in citing this condition is to encourage POS enhancements to reduce or eliminate periods of POS inoperability.

We appreciate the efforts of WSF in addressing the remainder of the conditions in Finding 2.

3. The Department Of Transportation (DOT), Washington State Ferries (WSF) Should Strengthen Internal Controls Over Payroll

The following internal control weaknesses exist in the WSF system used for time keeping and payroll processing of union employees:

a. The WSF labor/payroll records do not consistently show evidence of approval, authorization, and compliance with procedures for employee leave, overtime, and other compensatory time including penalty pay and travel time. However, WSF maintains logs (dispatcher logs, shop logs, vessel logs, engine logs, and terminal department time logs) that include some payroll data. While not all of these logs are intended solely for payroll purposes, some are used by WSF to prepare time sheets and to verify accuracy of time reported. The information on the logs is not reconciled by supervisors to the time sheets nor are differences adequately explained.

We reconciled terminal department time logs to the employees' time sheets for the March 16 to 31, 1996, payroll period, one of twenty-four annual pay periods. We found 184 variances between payroll data between the logs and time sheets. These discrepancies resulted in employees being paid incorrectly and leave being misreported.

b. Union agreements prescribe the circumstances justifying the payment of penalty pay. WSF has no written procedures nor standard guidelines for documenting, verifying, or authorizing payment for work performed in a penalty pay environment.

c. Documentation was insufficient to demonstrate that overtime was always properly approved and controlled. We tested overtime paid to deck employees for the March 16 to 31, 1996 payroll period. We identified 182.5 hours of potential overpaid overtime. Of these hours, WSF was unable to explain the basis for payment of 105.5 hours or $4,144.

d. Reimbursement for travel time was not properly documented and supported on the time sheets. Travel time between ferry terminals is specified in Schedule A of the union contracts. However, when the schedule is not used, variations are not adequately explained. We tested travel time paid to the deck, engine, and Eagle Harbor department employees for the March 16 to 31, 1996 pay period. We identified 111.25 hours of potentially overpaid travel time. Of these hours, WSF was unable to explain the basis of payment for 47.5 hours or $1,293.

e. Duties are not adequately segregated. In some instances the same person prepares and approves the time sheets for payment. In the payroll office, employees responsible for preparing warrants are also responsible for mailing payroll warrants.

We previously reported these conditions in the 1995 *State of Washington Single Audit Report* (SWSA), Finding 83 and in the 1994 SWSA, Finding 89.

The State of Washington Office of Financial Management (OFM) *Financial and Administrative Policies, Regulations, and Procedures* manual, Section 6.1.1.1.5.a states that:

> Each agency director has the responsibility for establishing and maintaining on an ongoing basis an effective system of internal accounting control throughout the agency in accordance with Internal Control and Auditing policies . . . of this manual.

Section 6.2.2.1.10 provides guidance on minimum internal control procedures necessary to control payroll disbursements.

WSF management attributes these conditions to factors relating to the distributed nature of fleet operations combined with timelines imposed by the state payroll system. Additionally, a reliance on site-based timekeeping systems on the vessels do not provide a consistent record for SAO to review.

By failing to require adequate documentation for hours claimed on time sheets, the agency may have paid inappropriate amounts for regular time, penalty time, overtime, and travel time. In failing to require proper segregation of duties, errors and irregularities may have occurred without detection.

We recommend DOT Washington State Ferries implement a system which ensures payment to employees are appropriate, properly authorized, supported, and controlled.

Auditee's Response

a. Partial Concurrence

WSF continues to believe that a signature of approval by the appropriate staff person on a time sheet constitutes verification of hours worked and authorization of time for payment. We also believe that the various logs, although a potential source for time keeping, are not kept primarily for this purpose and may or may not be appropriate for time keeping.

WSF does intend to implement a payroll specific daily time record, similar to those used in the terminals, for use on vessels. The goal is to find an appropriate time recording tool that will accommodate the itinerant nature of our business. We will consult with the Office of Financial Management regarding the reasonableness of the new record and any related procedures within the constraints of our distributed operation and the timeliness imposed by the state payroll system by May 31, 1997.

b. Concurrence

WSF payroll manuals were updated in FY95 to include more specific instructions on penalty pay. While WSF continues to believe that a signature of approval by the appropriate staff person on a timesheet constitutes verification of time worked and authorization of time for payment, we agree more clarification may be needed here. The WSF Operations Department will issue more detailed guidelines for penalty pay to supplement the negotiated agreement by April 1997.

c. Partial Concurrence

During their testing of overtime, SAO was concerned that the timesheets were not consistent with the ships' logs. WSF contends that the ships' logs should not be used as verification of the timesheets. While the ships' logs give general information regarding the activities on the ferries, they do not and are not expected to record every detail of activity. For example, prior to dismissing a crew from their shift, each supervisor is responsible to ensure that the necessary cleanup activities are completed on the ferries. If additional work is required to accomplish this job, overtime may be authorized. By signing the timesheet, the supervisor has authorized and approved this overtime. WSF payroll manuals were updated in FY95 to reflect which positions have the authority to authorize overtime. WSF is also working on a new daily time record noted in item a. above. Once implemented, the new document should provide the added documentation being sought by SAO.

d. Concurrence

Payroll manuals were updated in FY95 to reflect the need to use schedule A or provide an adequate explanation of variance on the time sheet. WSF has issued revised time sheets and instructions to vessel and terminal employees to more obviously reflect the need for the added data.

e. Concurrence

All time sheets are now reviewed and audited by a different person. Because of time constraints, staffing levels, and limited resources, it is not possible to change the way payroll warrants are handled.

Auditor's Concluding Remarks

We recognize that the logs are not solely intended for payroll purposes, however, the logs are used by WSF for timesheet preparation and to verify the accuracy of time reports. Until WSF implements the new daily time records, we will continue to use the logs and verbal explanation provided by appropriate personnel to support recorded hours. Accordingly, we reaffirm the conditions. We will review the corrective action during the fiscal year 1997 audit.

4. The Department Of Transportation (DOT), Washington State Ferries (WSF) Should Obtain Sufficient Documentation Before Paying Private Vehicle Mileage Expenses

Private vehicle travel mileage reimbursement at WSF is paid without sufficient documentation. WSF employees use a semimonthly time sheet to report private vehicle mileage incurred as part of the employee's duties. The time sheet information is then used by the WSF payroll division to reimburse employees for mileage included in the regular bi-monthly payroll warrant. WSF uses this process instead of requiring employees to submit separate travel vouchers.

We noted the following deficiencies when vehicle mileage expenses are reimbursed using this method:

a. The official station and residence, origination, destination, and purpose of the trip are not always clearly indicated on the time sheet.

b. For travel between ferry terminals, a mileage schedule is included in the union contract and is supposed to be used for mileage reimbursement. The schedule was not consistently used nor were variations from the schedule adequately explained.

We tested private travel mileage reimbursement recorded on time sheets from the payroll period of March 16 to 31, 1996, one of twenty-four annual pay periods for the deck, engine, and Eagle Harbor departments. The testing indicated 166 of 504 mileage reimbursement requests did not include adequate information. In addition, we identified 2,700 miles of potentially overpaid reimbursed private vehicle mileage. Of these reimbursements, WSF was unable to explain the basis for payment of 1,761 miles or $528.

We previously reported these conditions in the 1995 *State of Washington Single Audit Report* (SWSA), Finding 57 and in the 1994 SWSA, Finding 63.

The State of Washington Office of Financial Management (OFM) *Financial and Administrative Policies, Regulations, and Procedures* manual, Section 4.2.3.3.1 states that:

> Travel expense vouchers are to be completed in accordance with the . . .
> detail required on the Travel Expense Voucher . . . form.

The travel expense voucher requires identification of the origination, destination, depart/return time, purpose of the trip, and mileage.

WSF management indicates that the conditions continued because new timesheets were not introduced until the 1997 fiscal year, and state payroll timelines do not provide adequate time for supervisory review. The result of this deficiency is that WSF staff is unable to audit and substantiate claims for reimbursement for private vehicle mileage because sufficient information is not included on the time sheets.

We recommend that DOT Washington State Ferries require adequate documentation of private vehicle mileage either on the time sheet or through another method.

Auditee's Response

a. Concurrence

Payroll manuals were updated in FY95 to reflect this requirement. Revised time sheets and instructions were issued to vessel and terminal staff in November 1996 to more obviously reflect the need for the added data and work with those authorizing travel to improve compliance. The new forms have been in use since January 1997. We will conduct an internal review for compliance in April 1997. The payroll manager is working with Eagle Harbor Management to revise the forms that are used for Eagle Harbor staff. Our goal is to pilot a new form or process by April 1997 for Eagle Harbor.

b. Concurrence

Payroll manuals have been updated to reflect this requirement. As noted above, WSF has revised vessel and terminal time sheets to more obviously reflect the need for the added data to support variations. We will also work with employees submitting travel and those authorizing travel to improve compliance.

Auditor's Concluding Remarks

We appreciate the efforts of DOT in addressing this finding and will review the corrective action during our next regular audit.

5. The Department Of Transportation, Washington State Ferries Division (WSF) Vessel Engineering Department Should Comply With Purchasing Laws And Regulations

Our audit of purchases disclosed that WSF Vessel Engineering acquired temporary architectural or engineering professional staff services totaling $924,594 during fiscal year 1996 from a single vendor without either a written contract or documented competitive solicitation. Expenditures to this vendor, processed under the same conditions, totaled $832,950 in the previous fiscal year.

The correct classification of the purchase as Personal Services (PSC) or Architectural and Engineering Services (A&E) could not be determined due to the absence of a written contract.

Laws and regulations applicable to PSC and A&E procurement include:

RCW 39.29.011 for Personal Service Contracts states:

> **Competitive solicitation required** . . . All personal service contracts shall be entered into pursuant to competitive solicitation . . . .

The State of Washington Office of Financial Management *Policies, Regulations, and Procedures* manual, Section 4.3.1.1.9(a) requires that:

> A written document specifying the agreement . . . is to be prepared for all contracted personal services.

RCW 39.80.050 for Architectural and Engineering Services states:

> **Procurement of architectural and engineering services)Contract negotiations**. (1) The agency shall negotiate a contract with the most

> qualified firm for architectural and engineering services at a price which the agency determines is fair and reasonable . . . .

We previously reported this condition in the 1995 *State of Washington Single Audit Report* as Finding 72.

The WSF Division's director stated that the risk of disrupting the construction of the jumbo ferries was too high if WSF's method of acquiring architectural and engineering temporary staff services was changed during fiscal year 1996.

The absence of a written contract and competitive solicitation when acquiring PSC services or evaluation and negotiation for A&E services, where required, lessens the likelihood that WSF will obtain the most qualified firm at the most competitive price as required by state procurement laws and regulations. Without following appropriate purchasing regulations, the potential of irregularities is increased.

<u>We recommend</u> that the WSF Vessel Engineering Department execute a written contract for all temporary professional services acquired and follow state purchasing laws and regulations as applicable.

<u>*Auditee's Response*</u>

<u>*Concurrence*</u>

WSF's original purchase of these services was based on an examination of the availability of services in the market at the time. Based on that examination, the DOT procurement office authorized sole source purchase of this type of service. Because of concerns raised by SAO, the DOT procurement office has provided WSF with more recent guidance. During FY96 WSF worked with DOT contract's office to determine the type of contract needed and appropriate process under state law, developed specifications, issued solicitation, interviewed qualified respondent's and selected vendors. The WSF Contract Liaison is working to enter into those contracts. We are currently waiting for information we need from the vendors to complete them. These contracts are anticipated to be in place by May 31, 1997.

<u>Auditor's Concluding Remarks</u>

We appreciate the efforts of DOT in addressing this finding and will review the corrective action during our next regular audit.

6. <u>The Department Of Transportation (DOT), Washington State Ferries (WSF) Should Pay Vendors Promptly</u>

WSF does not pay vendors promptly. During fiscal year 1996, 40 percent of tested payments to vendors were not paid within 30 days, or to the terms of the purchase. However, the testing, which was conducted over a five month period, did indicate an improvement in timeliness of payment. Two hundred thirty-four vendor payment transactions were selected by the State Auditor's Office (SAO) and tested by the WSF staff, with verification procedures performed by SAO.

We previously reported this condition in the 1994 and 1995 *State of Washington Statewide Single Audit Report*, Findings 77 and 66, respectively.

The Office of Financial Management (OFM) *Policies, Regulations and Procedures* manual Section 2.2.3.2.3(I) states in part:

> I. Agencies are to establish internal control procedures to ensure timely, accurate, and cost effective payment of obligations to vendors. An agency's payments will be considered timely when its records show that the agency pays 95 percent or more of its obligations to vendors by the due date defined below. Agencies are to maximize effective cash management by paying as close to the due date as workable.
>
> > (1) **Due Dates** - Due dates for payments are established by the terms of contracts between the agency and vendors. If the contract is silent concerning terms or there is no written contract, the terms are net 30 days. The 30 days, or other terms, begin upon receipt of the goods or services or a properly completed invoice, **whichever is later**. Vendor payments are to be made by the due date. As prescribed in RCW 39.76, agencies, if billed, are required to pay interest at the rate of one percent per month on amounts of past due accounts. Due dates are postponed in the case of disputes . . . .

WSF management attributes this condition to the following:

a. A lack of automation in purchasing. When invoices are received there is no central database to tie them to an authorized order, requiring manual research and lengthening the time required to process payments. Current staff levels in purchasing do not provide adequate resources to conduct this manual research.

b. Inadequate levels of staff at the warehouse to support the volume of goods received and subsequent distribution of those goods. When goods are not receipted in a timely manner, invoices to vendors cannot be paid within the appropriate time.

c. Lack of training among some WSF staff regarding the importance of processing this paperwork in a more timely fashion.

Failure to pay vendors promptly increases the cost to the state by missing discounts and possibly incurring interest charges for late payment.

<u>We recommend</u> that DOT Washington State Ferries continue to implement procedures to ensure that vendors are paid promptly, and that vendor discounts are not lost.

<u>Auditee's Response</u>

<u>Concurrence</u>

WSF continues to have problems with the timeliness of payments to vendors. We have made some progress and the timeliness of vendor payments has improved. Surveys conducted since January 96 had the following results:

January 96	*48% paid within 30 days*
February 96	*56% paid within 30 days*
May 96	*85% paid within 30 days*
June 96	*81% paid within 30 days*

Short Term:

1. *Internal Audit conducted a prompt payment analysis to identify areas needing improvements. That analysis was completed in February 1997. Based on that analysis, the following changes are being implemented:*

    - *communicate with vendors regarding information needed to facilitate timely payment*
    - *not re-typing confirming purchase orders*
    - *provide direct fax communication to and from accounts payable to facilitate documentation turnaround*
    - *authorize accounts payable to make more decisions and to work directly with individuals who may have knowledge of the transaction rather than sending documentation back through purchasing*
    - *do not issue verbal order authorization without a faxed document*

2. *Invoices with discounts will be tracked in order to maximize the vendor discounts taken.*

3. *Temporary staff has been added at the warehouse to assist with receiving.*

4. *Continue current process improvement efforts underway.*

Long Term:

1. *We will continue staff awareness and training.*

2. *We are reviewing software options to automate our purchasing department. We plan to issue an RFP by April 30, 1997.*

3. *Prompt Payment Surveys will be conducted on a quarterly basis to measure performance and to help identify areas for process improvements.*

4. *Continue to seek more efficient ways of conducting our business to better accommodate the workload with existing staff.*

Auditor's Concluding Remarks

We will review the WSDOT corrective action taken during the fiscal year 1997 audit.

7. The Department Of Transportation (DOT) Needs To Improve Compliance With State Laws And Regulations Pertaining To Personal Service Contracts (PSC)

We tested 34 PSCs and any associated supplements for various attributes. Of these 34 contracts, deficiencies were noted in 16 contracts or contract supplements. Some of the contract or contract supplements contained multiple deficiencies and are therefore included in more than one of the conditions noted below.

a. Sixteen PSCs and amendments totaling $2,175,022 were not filed or approved by the Office of Financial Management (OFM). Included in this category are competitively procured contracts and one sole source contract.

RCW 39.29.055 states:

> (1) State-funded personal service contracts subject to competitive solicitation shall be filed with the office of financial management and the joint legislative audit and review committee and made available for public inspection at least ten working days before the proposed starting date of the contract.
>
> (2) The office of financial management shall review and approve state-funded personal service contracts subject to competitive solicitation that provide services relating to management consulting, organizational development, marketing, communications, employee training, or employee recruiting.

RCW 39.29.025 states in part:

> (1) . . . Substantial changes executed by contract amendments must be submitted to the office of financial management and the joint legislative audit and review committee, and are subject to approval by the office of financial management.
>
> (2) An amendment or amendments to personal service contracts, if the value of the amendment or amendments, whether singly or cumulatively, exceeds fifty percent of the value of the original contract must be provided to the office of financial management and the joint legislative audit and review committee.
>
> (3) The office of financial management shall approve amendments provided to it under this section before the amendments become binding and before services may be performed under the amendments.
>
> (4) The amendments must be filed with the office of financial management and made available for public inspection at least ten working days prior to the proposed starting date of services under the amendments.

RCW 39.29.018 states:

> (1) Sole source contracts shall be filed with the office of financial management and the joint legislative audit and review committee and made available for public inspection at least ten working days prior to the proposed starting date of the contract. Documented justification for sole source contracts shall be provided to the office of financial management and the joint legislative audit and review committee when the contract is filed. For sole source contracts of ten thousand dollars or more that are state funded, documented justification shall include evidence that the agency attempted to identify potential consultants by advertising through state-wide or regional newspapers.
>
> (2) The office of financial management shall approve sole source contracts of ten thousand dollars or more that are state funded, before any such contract becomes binding and before any

> services may be performed under the contract. These requirements shall also apply to sole source contracts of less than ten thousand dollars if the total amount of such contracts between an agency and the same consultant is ten thousand dollars or more within a fiscal year. Agencies shall ensure that the costs, fees, or rates negotiated in filed sole source contracts of ten thousand dollars or more are reasonable.

b. Two of the tested PSCs for amounts of $10,000 or greater totaling $96,018 were found to be lacking adequate documentation of competitive solicitation.

RCW 39.29.011 states in part:

> All personal service contracts shall be entered into pursuant to competitive solicitation . . . (except those specifically excluded by this section).

c. One state funded sole source contract was not advertised as required.

RCW 39.29.018 states in part:

> (1) . . . For sole source contracts of ten thousand dollars or more that are state funded, documented justification shall include evidence that the agency attempted to identify potential consultants by advertising through state-wide or regional newspapers.

OFM has several regulations concerning PSCs as noted in the OFM *Financial and Administrative Policies, Regulations, and Procedures* manual, Section 4.3.

Similar conditions were reported in the 1995 *State of Washington Single Audit Report*, Finding 73.

In an effort to improve agency procedures for personal service contracts, DOT introduced several changes in the administration of these contracts. DOT also significantly revised the existing processing guidelines as now contained in the DOT *Consultant Services Procedures Manual*. The manual was published late in fiscal year 1996.

According to DOT management, the noncompliance cited was attributable to staff managing personal service contracts without adequate knowledge of state requirements governing such contracts. In addition, the *Consultant Services Procedures Manual* was not published until March 1996, thus delaying its impact for fiscal year 1996, which ends June 30, 1996. This manual provides better definition of responsibility for personal service contracts compliance within the agency than the previous directive.

Failure by the DOT to comply with the regulations surrounding personal service contracts circumvents the legislative intent of RCW 39.29. Bypassing state statute allowed the agency to expend funds for contracts that had not been approved and subjected DOT officers and contractors to potential civil penalties.

<u>We recommend</u> that the DOT carefully align the procedures related to personal service contracts across all agency functions and regions in order to comply with state requirements.

We further recommend that the Attorney General redetermine whether penalties are applicable under RCW 39.29.020.

Auditee's Response

Partial Concurrence

A recent analysis conducted by the DOT Policies Studies Analysis Office has concluded that many of the personnel involved in these types of contracts do not understand the process adequately and may not know what information is available to instruct them in the proper procedures. The Department is taking the following actions to assure compliance with the appropriate regulations:

1) A letter will be sent to all divisions to alert them to potential contracting noncompliance. It will point out common mistakes to avoid and what manuals or instructions are available to assist them. This should be accomplished by March 12, 1997.

2) A task force is being formed to analyze the Department's current contracting procedures to consider the need for oversight, training and written guidance. As part of the task force duties, it will assess the need to modify the delegation of authority documents as they relate to Personal Service Contracts.

As the recommendations are implemented, there will be follow-up tracking after six months to measure effectiveness.

In response to condition a., the Department is working with the Office of Financial Management (OFM) regarding the issue of professional services versus personal service contracts. Six of the sixteen referenced contracts are being disputed by the Department as Architect and Engineering (A&E) contracts. The SAO contacted OFM during the audit process to discuss the scopes of work of several contracts to determine if they were A&E or personal service contracts. OFM determined that they were personal service contracts.

The Department does not agree with the SAO and OFM interpretation that these contracts are personal service contracts. The Department believes that the scopes of work of the questioned contracts fall under the definition of A&E services. All of the contracts were awarded to engineering firms who were performing engineering functions.

According to RCW 18.43.020 (5) Practice of engineering: "The term "practice of engineering" within the meaning and intent of this chapter shall mean any professional service or creative work requiring engineering education, training, and experience and the application of special knowledge of the mathematical, physical, and engineering consultation, investigation, evaluation, planning, design and supervision of construction for the purpose of assuring compliance with specifications and design, in connection with any public or private utilities, structures, building, machines, equipment, processed, work, or projects."

In addition, three of the six contracts referenced above are funded by the Federal Highway Administration (FHWA). These contracts were awarded to and performed by engineering firms. The Department believes that the scopes of work of all four of the contracts involving FHWA funds fall under the federal definition of A&E services. According to 23 Code of Federal Regulations (CFR), Section 172.3 Definitions, Engineering and design services are defined as: "Program management, construction management, feasibility studies, preliminary engineering, design, engineering, surveying, mapping, or architectural related services."

The FHWA criteria does not appear to conflict with RCW 18.43.020 (5) Practice of Engineering, however the FHWA criteria does give specific types of examples of A&E services.

The Department had a meeting with OFM regarding the above noted contracts. The Department submitted additional information to OFM that may have not been available to OFM during the SAO audit. The contracts, supplements, scopes of work and correspondence were presented to OFM for their consideration and recommendation to SAO. However, regardless of OFM's recommendations, the Department still believes that the above noted contracts should be considered A&E services.

In response to condition b., one of the two contracts was with a non-profit organization to hire temporary intern personnel. The Department was working under previous guidance from OFM, which indicated that non-profit organization contracts did not have to be filed with OFM. This has since been clarified in coordination with OFM and Department of Personnel.

RESPONSE FROM DOT STAFF DEVELOPMENT

Four of the sixteen contracts cited were Staff Development contracts which were not properly approved by OFM.

Staff Development was not aware of filing and approval requirements affecting these contracts at the time they were processed. Upon notification of deficiencies, information was disseminated, and processing was revised to comply with the OFM requirements. A memo dated February 26, 1997 was developed in coordination with OFM and distributed to all personnel within Staff Development. This clarification will help insure that proper procedures for filing and approval are followed.

Auditor's Concluding Remarks

We affirm our interpretation of the definition information contained in the cited criteria. We will review the corrective action in the next annual audit.

8. Department of Transportation (DOT) Employees Used Public Assets For Private Gain

Two employees removed scrap aluminum highway signs from the DOT Northwest Regional Office (NWRO) and sold these public assets to a scrap metal dealer for at least $52,984 during the period March 1, 1994 through March 31, 1996. The employees then retained the proceeds of these transactions for their own personal gain.

Both employees were convicted of trafficking in stolen property in the first degree. The court ordered payment of the full amount of $52,984 in restitution from the two defendants.

Article XI, Section 14, *Constitution of the State of Washington* states in part:

> **PRIVATE USE OF PUBLIC FUNDS PROHIBITED**. The making of profit out of county, city, town, or other public money, or using the same for any purpose not authorized by law, by any officer having the possession or control thereof . . . .

RCW 42.52.160 states:

> **Use of persons, money, or property for private gain**. (Effective January 1, 1995.) (1) No state officer or state employee may employ or use any person, money, or property under the officer's or employee's official control or direction, or in his or her official custody, for the private benefit or gain of the officer, employee, or another . . . .

Office of Financial Management (OFM) *Financial and Administrative Policies, Regulations, and Procedures* manual, Part 6.2.2.1.9.e and 6.2.2.1.9.f states in part:

> Effective control procedures are to be established to ensure that state . . . assets are used properly and for authorized purposes. In addition, controls are to be established so that state property does not leave the possession of the state except under proper authorization.
>
> . . . Special protective measures are to be taken for items having a high pilferage rate or a high value.

DOT staff made an inquiry into the theft and found the following weaknesses allowed these losses to occur. DOT did not have internal controls to properly record, monitor, and manage the inbound receipt, on-hand inventory, or outbound processing of scrap aluminum signs and uprights. For example, while DOT contracts calling for the removal of existing aluminum signs require the contractor to deliver used sign parts to DOT, the NWRO had no documentation indicating what or how many signs the contractor actually delivered. In addition, while the NWRO had an area designated for salvaged metal parts, the amount of aluminum recycled from this area was not recorded.

DOT has a personnel dishonesty bonding policy for all employees. The policy's deductible provision is $100,000.

<u>We recommend</u> DOT review overall accounting controls over the processing and recycling of scrap aluminum highway signs and uprights, correct the weaknesses outlined above, and implement an effective system of internal control designed to ensure the protection of public assets.

We are also referring this matter to the Executive Ethics Board pursuant to their authority under Chapter 42.52 RCW.

<u>*Auditee's Response*</u>

<u>*Concurrence*</u>

Prior to the work conducted by the State Auditor's Office, a team was formed by Field Operation Support Service Center, to review the current procedures for handling aluminum construction and road direction signs. In reviewing the existing procedures, the team recognized several areas where the process could be improved. After further research and assessment, new procedures were established and incorporated in a memorandum dated December 6, 1996, Recycling of Aluminum.

Part of the team's review focused on the cost/benefit and associated risks of having less than absolute accountability. If there were to be an item for item level of accountability with the signs, the cost would be prohibitive. The controls stipulated in the December 6 memorandum should strengthen the process but do not represent 100% coverage. This is a level of risk that we are willing to accept. During fiscal year 97 we will spot check the new process to determine its effectiveness and the accountability of used signs. At the same time we will be documenting the accuracy of the information obtained and if necessary, make mid-stream adjustments to the revised the procedures where a need exists.

<u>Auditor's Concluding Remarks</u>

We appreciate the efforts of WSDOT to correct the conditions noted in this finding and will review the corrective action during our next regular audit.